IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-187

BACHE & CO., INC.,

Petitioner,

—v.—

CY SEYMOUR,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

ALEX L. ROSEN, Esq.
Attorney for Respondent
225 Broadway
New York, New York 10007
(212) BA 7-1787

Of Counsel:

LEON B. LIPKIN
JOSEPH ARONAUER

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2. Did the United States District Court, Southern District of New York, err when it denied a motion to stay a securities action when the complaint alleges violations of the 1934 Securities Exchange Act[1] but not the 1933 Securities Act[2]?

STATEMENT OF THE CASE

Plaintiff Cy Seymour ("Seymour") instituted this action against Defendant Bache & Co. Inc. ("Bache") and defendant Alex Canaan ("Canaan") to recover damages caused by the churning of Seymour's securities account.

The complaint alleges that Canaan was Seymour's account executive from July 1, 1969 to May 31, 1974.[3] During this time period, Canaan was employed by Bache from July 1, 1969 through April 30, 1972. Canaan was then employed by the brokerage firm of Weis Securities Inc. from May 1, 1972 through April 30, 1973. Canaan then returned to Bache and was employed by them from May 1, 1973 through May 31, 1974.

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1 15 U.S.C. 78a et. seq. (hereinafter "the 1934 Act").

2 15 U.S.C. 77a et. seq. (hereinafter "the 1933 Act").

3 The allegations of the complaint should be taken as true when a Court determines whether to grant a defendant's motion to stay an action because of an agreement to submit disputes to arbitration. See Maheu v. Reynolds & Co. 282 F.Sup. 423, 428. (S.D.N.Y. 1967).

On December 5, 1970, Seymour entered into a margin agreement with Bache which contained an arbitration provision.[4] When Canaan returned to Bache, Seymour signed another margin agreement on June 4, 1973, which contained the same arbitration provision as the December 5, 1970 agreement.

The complaint alleges that from July 1969 until May 1974, Canaan exercised control over Seymour's account and caused an excessive number of transactions in Seymour's securities account. The complaint also alleges that Bache, among other things, failed to properly supervise the activities of Canaan. The acts of Canaan and Bache are alleged to be violations of Rule 10b-5 of the 1934 Act.[5]

Bache and Canaan then moved on or about September 4, 1975 to stay the action on the ground that there was an agreement to arbitrate any disputes. Seymour submitted a memorandum of law in opposition to the defendants' motion.

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4 This provision states in pertinent part that:

> This contract shall be governed by the laws of the State of New York....any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or to the breach thereof, shall be settled by arbitration in accordance with the rules then obtaining of the American Arbitration Association or the Board of Governors of the New York Stock Exchange, as I may elect....

5 17 C.F.R. Section 240.10b-5.

On January 14, 1976, the United States District Court, Southern District of New York, Charles H. Tenney, J., denied the defendants' motion to stay the action on the ground that the agreement to arbitrate was not enforceable in light of the holding of the United States Supreme Court in Wilko v. Swan, 346 U.S. 427 (1953). On May 12, 1976, the United States Court of Appeals for the Second Circuit summarily affirmed the memorandum decision of Judge Tenney.

POINT I

SEYMOUR DID NOT HAVE KNOWLEDGE OF HIS CLAIM OR OF THE EXISTENCE OF A CONTROVERSY WHEN HE SIGNED THE MARGIN AGREEMENT AND THUS THE LOWER COURTS PROPERLY REFUSED TO STAY THIS ACTION

In Wilko v. Swan, supra, a stock purchaser brought suit against a brokerage house, charging violations of Section 12(2) of the 1933 Act. The plaintiff in Wilko had signed a margin agreement with a broadly worded arbitration provision. The Court held that the arbitration clause was a condition and waiver within the meaning of Section 14 of the 1933 Act, which states that such conditions and waivers are void. Accordingly, the Court held that the arbitration clause was unenforceable.

Bache contends that because Seymour signed the June 4, 1973 margin agreement after all the disputed transactions took place, Wilko is not applicable. Petition, page 4.

This contention overlooks the nature of a churning scheme. While a victim of a churning scheme may be aware of the number of trades in his account, the victim may not be aware that the trades are excessive under the circumstances. See Hecht v. Harris, Upham & Co., 283 F.Sup. 417, 433 (N.D. Cal. 1968), modified on other grounds, 430 F.2d 1202 (9th Cir. 1970); See also Note, Churning by Securities Dealers 80 Harv.L. Rev. 869 (1967). Further, the victim of a churning scheme may not be aware that the high number of trades is induced by a broker anxious to earn even more commissions. See Hecht v. Harris, Upham & Co., supra, at 433.

Thus, the present case is clearly distinguishable from cases which have upheld an agreement to arbitrate when the plaintiff is aware of his claim but knowingly chooses to assert that claim in an arbitration forum. See, e.g., Moran v. Payne, Weber, Jackson & Curtis, 389 F.2d 242 (3rd Cir. 1968); Korn v. Franchard Corporation, 388 F.Sup. 1326 (S.D.N.Y. 1975).

Bache does not assert that Seymour was aware of the possible claim against it when he signed the margin agreements. Any such assertion by Bache would be untenable since the complaint read as a whole denies that Seymour had such knowledge, and the allegations of the complaint must be deemed to be true.[6] Indeed, Judge Tenney found that:

> The waiver contained in the instant arbitration clause, signed in December 1970, even if after some of the alleged violations had occurred, was sufficiently in advance of the existence of a controversy to void the agreement. Plaintiff

[6] See Maheu v. Reynolds & Co. 282 F.Sup. 423, 428 (S.D.N.Y. 1967)

was simply not in a position in December of 1970 to make a voluntary and intelligent waiver of important rights. The fraudulent scheme charged in the complaint was on-going and extended well beyond December of 1970. Thus, even if acts prior to that date could arguably be the subject of an arbitration agreement, clearly those later acts would not properly be the subject of a valid agreement.

The margin agreement signed by plaintiff on June 4, 1973, when he returned his account to Bache is likewise of no avail. When plaintiff returned to Bache in 1973 a new relationship was instituted. The margin agreement signed in furtherance of this new agreement cannot be construed as granting a waiver retroactively to all past acts, particularly those the subject of the previous business relationship. Even if it could be argued that the dates of the margin agreements might confer jurisdiction as to some transactions and not as to others, judicial economy dictates that this entire matter be tried in one forum. This conclusion is further supported by the apparent presence of defendant Canaan as the common thread that runs throughout the scenario. App. of Petition, pp. 8a, 9a.

In short, the margin agreements are waivers in advance of a controversy and such waivers should not be upheld by the Courts. Wilko v. Swan, supra, at 438, n. 31 citing Brooklyn Savings Bank v. O'Neil, 324 U.S. 697 (1945).

POINT II

THE DOCTRINE OF WILKO v SWAN IS APPLICABLE TO VIOLATIONS OF THE 1934 ACT

Wilko deals with alleged violations of Section 12 of the 1933 Act. Bache asserts in a rather oblique fashion that since the complaint alleges violations of the 1934 Act but not the 1933 Act, Wilko is not applicable to the present action. Pt. Brief Page 2.[7] Bache contends that the recent United States Supreme Court decision in Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974) supports its position.

The cases decided before Scherk v. Alberto-Culver Co., supra, clearly hold that Wilko is applicable to violations of the 1934 Act. See Maheu v. Reynolds & Co., supra; Stockwell v. Reynolds & Co., 252 F.Sup. 215 (S.D.N.Y. 1965); Reader v. Hirsch & Co., 197 F.Sup. 111 (S.D.N.Y. 1961). Scherk does not change the impact of these cases.

Scherk is based on the ground that in an international business transaction between parties of similar bargaining strength an arbitration provision should be enforced. Scherk v. Alberto-Culver Co., 417 U.S. at 515, 516; see also Note - Arbitration Clauses in International Contracts and the Extra Territorial Reach of the Securities Exchange Act of 1934 in Light of Scherk v. Alberto-Culver Co., 26 Syracuse L.Rev. 995 (1975); Note - Arbitration and Securities Regulation - Conflict Between Federal Arbitration Act and Securities Exchange Act in an International Transaction 40 Mo. L.Rev. 527, 534 (1975).

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[7] This issue is presented in the petitioner's brief as the third question presented to the Court but Bache does not otherwise deal with this issue in its petition.

There is one reported case which deals with the impact of Scherk on Wilko. In Newman v. Shearson, Hammill & Co., Incorporated, 383 F.Sup. 265 (W.D. Tex. 1974), the court noted that Scherk did not overrule Wilko since Scherk is only applicable to international business transactions. Judge Tenney properly followed the Newman decision. See Petitioner's App. p.10(a).

The 1934 Act contains a similar non-waiver provision as the 1933 Act. Compare §29(a) of the 1934 Act, 15 U.S.C. 78cc with §14 of the 1933 Act, 15 U.S.C. 77n. The court's holding in Wilko was grounded on the conclusion that the intention of Congress concerning the sale of securities is better carried out by holding arbitration agreements invalid. Wilko v. Swan, 417 U.S. at 438. Certainly, Congress expressed similar concern with respect to claims under the 1934 Act. See, §29(a) of the 1934 Act, 15 U.S.C. 78cc (non-waiver provision); §10 of the 1934 Act, 15 U.S.C. 78j (fraud provision); §18 of the 1934 Act, 15 U.S.C. 78r (liability for misleading statements); §20 of the 1934 Act, 15 U.S.C. 78t (liabilities of controlling persons); §27 of the 1934 Act, 15 U.S.C. 78aa (exclusive jurisdiction provision).

POINT III

BACHE OFFERS NO REASON WHY THE COURT SHOULD GRANT THE WRIT OF CERTIORARI

Bache offers no argument why the Court should grant a writ of certiorari. Such an argument is required in all petitions for certiorari. See Supreme Court Rule 23(1)(h).

Bache does not claim that the Second Circuit decision is in conflict with the decision of another Court of Appeals. Clearly, there is no important state or territorial question of law involved in this action. The Second Circuit simply followed the Supreme Court decision in Wilko. Under these circumstances, the Court should not grant a writ of certiorari. See Supreme Court Rule Section 19(1)(b).

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be denied.

Dated: New York, New York
August 10, 1976

Respectfully submitted,

ALEX L. ROSEN, ESQ.
Attorney for Respondent
225 Broadway
New York, New York 10007
(212) BA7-1787

Of Counsel:
Leon B. Lipkin
Joseph Aronauer